



[6710-01-P]

FARM CREDIT SYSTEM INSURANCE CORPORATION

Policy Statement Concerning Assistance to Troubled Farm
Credit System Institutions

AGENCY: Farm Credit System Insurance Corporation.

ACTION: Policy statement; request for comments.

SUMMARY: The Farm Credit System Insurance Corporation (Corporation or FCSIC) is publishing for comment a draft Policy Statement Concerning Assistance to Troubled Farm Credit System (System) Institutions to replace the Corporation's present Policy Statement Concerning Stand-Alone Assistance. The draft revised policy statement provides additional transparency concerning the Corporation's authority to provide assistance and how the least-cost test might be performed. The draft revised policy statement also includes enhanced criteria of what is to be included in assistance proposals, and a new section discussing assistance agreements.

DATES: Written comments must be submitted on or before [Insert date 30 days after publication in the Federal Register].

ADDRESSES: Comments should be mailed or delivered to James M. Morris, General Counsel, Farm Credit System Insurance

Corporation, McLean, Virginia 22102. Copies of all comments will be available for examination by interested parties in the offices of the Farm Credit System Insurance Corporation.

FOR FURTHER INFORMATION CONTACT:

Wade Wynn, Senior Risk Analyst, and James M. Morris, General Counsel, Farm Credit System Insurance Corporation, 1501 Farm Credit Drive, McLean, Virginia 22102, (703) 883-4380, TDD (703) 883-4390.

SUPPLEMENTARY INFORMATION:

The Corporation, in its sole discretion, is authorized under section 5.61(a) of the Farm Credit Act of 1971, as amended (Act),¹ to provide assistance to a stand-alone System institution or to facilitate a merger or consolidation of a System institution with another System institution, provided it meets the statutory least-cost test.² If the Corporation receives a request to assist a troubled System institution, it must compare the cost of liquidation to the cost of providing assistance to determine the least costly alternative to the Insurance Fund. If the cost of providing assistance is less than the cost of liquidation, the Corporation's Board of Directors has a basis for granting assistance to a troubled System institution. In making this determination, the Corporation is authorized

¹ 12 U.S.C. 2277a-10.

² See Act, section 5.61(a)(3), 12 U.S.C. 2277a-10(a)(3).

under section 5.59(b) of the Act³ to gather any information as is necessary from the troubled System institution or any such other System institution to perform the least-cost test. After gathering all pertinent information, the Corporation must: 1) Evaluate alternatives on a present-value basis, using a reasonable discount rate, 2) document the evaluation and the assumptions on which the evaluation is based, and 3) retain the documentation for not less than 5 years.

The Corporation's existing policy statement is, for the most part, a summary of the powers of the Corporation under section 5.61(a) of the Act to provide assistance to a System institution, including the timing and steps for making the least-cost test.⁴ For example, the policy specifies that the Corporation's Board of Directors must determine that providing assistance is the least costly means of all possible alternatives available to the Corporation, including liquidation of the System institution, and lists the steps for conducting the statutory least-cost test. The existing policy statement also provides a list of criteria of what the Corporation expects to receive in assistance proposals to help the Corporation conduct the least-cost test.

³ 12 U.S.C. 2277a-8(b).

⁴ 12 U.S.C. 2277a-10.

The Corporation is now publishing for comment a revised "Policy Statement Concerning Assistance to Troubled Farm Credit System Institutions." The revised policy statement provides additional transparency concerning the Corporation's authority to provide assistance and how the least-cost test might be performed. The revised policy statement also includes more detailed criteria concerning what is to be included in assistance proposals, and a new section discussing assistance agreements. The text of the "Policy Statement Concerning Assistance to Troubled Farm Credit System Institutions" is set out below in its entirety:

FARM CREDIT SYSTEM INSURANCE CORPORATION
POLICY STATEMENT CONCERNING
ASSISTANCE TO TROUBLED FARM CREDIT SYSTEM INSTITUTIONS

Background

The Farm Credit System Insurance Corporation (Corporation), in its sole discretion, is authorized under section 5.61(a) of the Farm Credit Act of 1971, as amended (Act), 12 U.S.C. 2277a-10(a), to provide assistance, on such terms and conditions as the Corporation's Board of Directors may provide, to:

(1) A stand-alone "troubled Farm Credit System (System) institution"⁵ in the form of loans, asset or debt security purchases, assumption of liabilities, or contributions: (a) To prevent the placing of the institution into receivership, (b) to restore the institution to normal operation, or (c) to reduce the risk to the Corporation posed by the institution when severe financial conditions threaten the stability of a significant number of other System institutions or System institutions possessing significant financial resources; or

(2) Facilitate a merger or consolidation of a "qualifying"⁶ troubled System institution with another System institution through loans, loan guarantees, asset or debt security purchases, assumption of liabilities, contributions, or any combination thereof.⁷

If the Corporation receives a request for assistance to resolve a troubled System institution, it must compare the

⁵ A troubled System institution is one that is in danger of failing. The Act uses the terms "insured System bank" and "bank" but specifies under section 5.61(e), 12 U.S.C. 2277a-10(e), that such terms include production credit associations and other associations making direct loans under the authority provided under section 7.6 of the Act, 12 U.S.C. 2279b. For the purposes of this policy statement, the terms "troubled System institution" or "troubled institution" are used throughout to refer to any of these institutions needing assistance under section 5.61(a) of the Act, 12 U.S.C. 2277a-10(a), to avoid liquidation.

⁶ "Qualifying" means the troubled System institution is: 1) In receivership, 2) in danger of being placed in receivership or 3) determined by the Corporation to be in need of assistance. See Act, section 5.61(a)(2)(B), 12 U.S.C. 2277a-10(a)(2)(B).

⁷ The Corporation is not authorized to purchase voting stock from the troubled System institution. See Act, section 5.61(a)(3)(F), 12 U.S.C. 2277a-10(a)(3)(F).

cost of liquidation to the cost of providing assistance to determine the least costly alternative to the Insurance Fund.⁸ If the cost of providing assistance is less than the cost of liquidation, the Corporation has a basis for granting assistance to the troubled System institution. In making this determination, the Corporation is authorized to gather any information as is necessary from the troubled System institution or any such other System institution to perform the least-cost test.⁹ After gathering all pertinent information, the Corporation must: 1) Evaluate alternatives on a present-value basis, using a reasonable discount rate, 2) document the evaluation and the assumptions on which the evaluation is based, and 3) retain the documentation for not less than 5 years.¹⁰

Policy Statement

In general, the Corporation would consider a request for assistance to a troubled System institution under

⁸ The cost of liquidation shall be made as of the earliest of: (I) The date on which a conservator is appointed for the institution, (II) the date on which a receiver is appointed for the institution, or (III) the date on which the Corporation makes any determination to provide assistance to the institution. See Act, section 5.61(a)(3)(C), 12 U.S.C. 2277a-10(a)(3)(C).

⁹ See Act, sections 5.58(8) and 5.59, 12 U.S.C. 2277a-7(8) and 2277a-8. The Corporation will accord such other System institutions as the Corporation determines to be appropriate the opportunity to submit information relating to the determination. See Act, section 5.61(a)(3)(A), 12 U.S.C. 2277a-10(a)(3)(A).

¹⁰ See Act, section 5.61(a)(3)(B), 12 U.S.C. 2277a-10(a)(3)(B). In addition, in regards to requests for stand-alone assistance, the Corporation must evaluate the adequacy of managerial resources of the troubled System institution. The Corporation is authorized to determine the continued service of any director or senior ranking officer who serves in a policymaking role for the assisted System institution as a condition of granting assistance. See Act, section 5.61(a)(3)(D), 12 U.S.C. 2277a-10(a)(3)(D).

section 5.61(a) of the Act, 12 U.S.C. 2277a-10(a), after other resolution alternatives have been exhausted such as voluntary assistance provided from within the System, voluntary merger with one or more System institutions, or involuntary merger with one or more System institutions as determined by the Farm Credit Administration (FCA) under section 4.12 of the Act, 12 U.S.C. 2183.

Request for Assistance

A System institution requesting assistance must submit a proposal to the Corporation.¹¹ If the proposal is for stand-alone assistance, the proposal must provide justification for the assistance, including a detailed analysis of how such assistance will return the troubled System institution to a financially viable, self-sustaining operation. If the proposal is to facilitate a merger, the analysis must demonstrate that the continuing System institution can safely and soundly absorb the financial and operational impact that will result from the merger. Moreover, the Corporation would also consider FCA's preliminary approval of the proposed merger, pending the least-cost determination to provide assistance.

¹¹ A request for assistance can be initiated either directly from a troubled System institution, an acquirer or acquirers interested in purchasing a troubled institution, or, if the troubled institution is an association, from its funding bank.

Assistance proposals must contain information to help the Corporation compare the cost of providing assistance to the cost of liquidating the troubled System institution as part of its least-cost determination. Assistance proposals can include requests for loans, loan guarantees, loss-sharing arrangements, asset or debt security purchases, assumption of liabilities, or cash contributions. The Corporation will consider the nature of the financial assistance requested on a case-by-case basis and may alter the form or amount of assistance as part of the least-cost determination. To expedite the least-cost analysis, the Corporation has identified the following minimum criteria to be included in assistance proposals:

- 1) Financial condition and performance criteria to better understand the problem that caused the need for assistance, including the rationale for seeking assistance;
- 2) The type and amount of assistance needed, as well as a reasonable repayment plan. Assistance proposals must include fee arrangements with attorneys, accountants, consultants, and other parties incident to the request for assistance (or projected costs for these arrangements). Assistance proposals should not presume that the Corporation would

acquire or service assets of the assisted institution without a strong justification;

- 3) Reasonable projections to assess the future viability of the institution after assistance has been provided. This would include earnings projections and a capital restoration plan to achieve adequate capitalization. Earnings projections and the capital restoration plan must include the impact of repayment of assistance;
- 4) A business plan that would implement written policies and procedures designed to guide operations safely and soundly and to correct the problems that caused the need for assistance. The plan must include an internal control system to monitor ongoing performance with measurable criteria. The plan must also include an operating budget, including compensation arrangements covering directors and senior officers. Plans to continue the service of directors and senior officers must be pre-approved by the Corporation before assistance is granted. Moreover, compensation arrangements covering directors and senior officers are subject to Corporation approval, both in granting assistance and until assistance is repaid; and

5) Analysis of the effect of assistance on shareholders, uninsured creditors (e.g., impairment on subordinated debt), other System institutions and the financial markets. If the troubled System institution is an association, the analysis must include the impact on its funding bank's ability to continue meeting its insured obligations.

The Corporation reserves the right to request additional information as needed to conduct the least-cost test.

The Least-Cost Test

The Corporation will conduct a least-cost test to determine whether providing assistance to a troubled System institution from the Insurance Fund is less costly than liquidating the institution. In making the least-cost determination, the Corporation shall use its examination authority under section 5.59(b) of the Act, 12 U.S.C. 2277a-8(b), to collect information from the troubled System institution to calculate the cost of liquidation.¹² This information shall, at a minimum, include specific data elements as determined by Corporation staff to conduct a present-value analysis of the troubled System institution's assets, using a reasonable discount rate. As required by

¹² The Corporation will request that FCA examiners collect the information.

the Act, the troubled System institution needing assistance must provide the Corporation unrestricted on-site access to perform a due diligence review of all information related to performing a least-cost analysis.

Once the cost of liquidation has been determined, the Corporation would then compare the cost of providing assistance to the cost of liquidation to make its least-cost determination. If the troubled System institution is a bank, the Corporation would conduct a simple cost comparison to determine the least costly alternative to the Insurance Fund. However, if the troubled System institution is an association, the least-cost test becomes more complex, and the Corporation would require additional information from the funding bank to make a least-cost determination. Since only bank obligations are insured, association failures do not necessarily result in a cost to the Insurance Fund. For example, it is possible that the failure of a small or mid-sized association will have no impact on the funding bank's ability to continue meeting its insured obligations. The funds received from liquidating the small or mid-sized association's assets may cover the principal and interest of its direct note to the bank, or the bank may be able to sufficiently absorb any losses not covered by liquidation

funds.¹³ In such situations, assistance would not be granted to the association, because its liquidation results in zero cost to the Insurance Fund. However, in situations where a sizable association fails, or several smaller associations fail, then it is possible that such failures could seriously threaten the funding bank's ability to continue as a going concern.¹⁴ In such situations, the Corporation's Board, in its discretion, may grant assistance, provided the financial assistance meets the least-cost test as specified in the Act.

In analyzing assistance requests for troubled System associations, the Corporation would need to consider the impact to the Insurance Fund over time. For example, the liquidation of a sizable association may not have an immediate impact on the funding bank's ability to continue meeting its insured obligations (which would mean no immediate loss to the Insurance Fund). However, such a large liquidation could create a significant disruption throughout the district. For instance, the liquidation of a considerable amount of agricultural loans in a relatively short period of time may cause a general decline in loan

¹³ It is also assumed that the loss of revenue would have minimal effect on the bank's ability to continue as a going concern.

¹⁴ The failures might cause the bank to default on its insured obligations, or cause the bank to become severely undercapitalized so as to put the bank into conservatorship or receivership, which in turn, could cause the bank to seek assistance from the Corporation.

prices throughout the district, creating higher levels of risk in the remaining association direct notes. Moreover, because the bank loses a significant source of revenue and capital, it might not be able to increase the cost of funds to the remaining associations to make up for lost revenue while simultaneously increasing their investment requirement to remain adequately capitalized.¹⁵ Without providing assistance to the sizable troubled association to prevent financial contagion, the bank might eventually fail, creating greater losses to the Insurance Fund.¹⁶ A similar scenario could result with the failure of several smaller associations during a period of severe stress in agriculture. Temporary cash infusions to troubled associations could counteract the effects of financial contagion and help avoid greater losses to the bank (and in turn potential losses to the Insurance Fund) in the long term. Consequently, the Corporation would need additional information from the funding bank to assess these interdependent risks before making a least-cost determination in relation to association requests for assistance.

¹⁵ These actions could weaken other associations or cause other associations in the district to fail.

¹⁶ On the other hand, assistance might be structured in such a way that the Corporation will recoup the cost associated with providing assistance.

As required by statute, the Corporation shall use the information it receives during its least-cost analysis to evaluate the alternatives, document the evaluation and the assumptions on which the evaluation is based, and retain the documentation for not less than 5 years.

Assistance Agreements

If assistance is granted, the Corporation will enter into an agreement with the System institution receiving assistance. The terms and conditions of the agreement will be determined on a case-by-case basis and may include limits on (or prior approval of) the types or amounts of activities the institution can engage in while assistance is outstanding. For example, assistance agreements might include repayment terms and limits on concentration risk, patronage and dividend payments, executive compensation, and certain types of expenses. Assistance agreements may also provide the Corporation the right to have a representative attend the institution's board meetings. Assistance agreements will be subject to the Corporation's Board of Directors' approval. While assistance agreements are outstanding, the Corporation will use its examination authority to ensure compliance with the agreement. Moreover, the Corporation will require the System institution receiving assistance to certify and publicly disclose compliance with

the agreement requirements, including the disclosure of any instances of material non-compliance with the agreement.

Dated: June 15, 2012_____

Dale L. Aultman,
Secretary to the Board,
Farm Credit System Insurance Corporation.

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